

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
February 18, 2005
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chairperson of the ASRS Board, called the meeting to order at 8:33 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Keith Meredith, Chairperson
Mr. Karl Polen, Vice Chairperson
Mr. Jim Bruner
Mr. David Byers
Mr. Jaime Gutierrez
Ms. Anne Mariucci
Mr. Michael Townsend
Mr. Lawrence Trachtenberg
Mr. Steven Zeman

Also Present: Mr. Chris Harris, Nominee

A quorum was present for the purpose of conducting business.

Dr. Meredith thanked Ms. Charlotte Borchert, for her three years of service to the ASRS Board, especially for her efforts on the Health Insurance Program.

Dr. Meredith congratulated Mr. Zeman on his retirement, informally accepted his resignation, and welcomed him on his re-appointment to the ASRS Board.

Dr. Meredith thanked Mr. Bruner for the completion of nine years of service on the ASRS Board. Dr. Meredith thanked Mr. Bruner on all his work and dedication especially on the Board Governance Project.

Dr. Meredith welcomed the newly appointed Trustees: Mr. Chris Harris, and Mr. David Byers to the ASRS Board.

2. Approval of the Consent Agenda

Motion: Mr. Jim Bruner moved to approve Refunds, Death Benefits, and System Transfers,

And

Approve the applications and agreements with the following employers:

- Linden Fire District
- RSD Charter School, Db. Intelli-School Charter School

And

Approve the minutes of the December 17, 2004, regular meeting of the ASRS Board,

And

Approve the extension of external audit contract,

And

Approve the notices of rulemaking docket opening for employee membership rules.

Mr. Karl Polen seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

3. Presentation, Discussion, and Appropriate Action Regarding the Actuary RFP

Mr. Townsend asked Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, to provide an overview. Mr. Guarino stated that recent changes in the way that ADOA is delegating and administering procurement authority, contracts for certain commodities and services will be combined into statewide contracts. Agencies with individual contracts will not be allowed to extend their contracts past the current extension period. Consequently, if the ASRS were to conduct an RFP for actuary services this year, it would not be permitted to extend that contract past the initial one-year term because a statewide actuary contract will be awarded in June of 2005. The statewide contract will meet the actuarial needs of the ASRS. (The ADOA has assigned Mr. Bob Wittsell of the ASRS as the Chief Procurement Officer for this RFP.)

All considered, the most prudent course of action would seem to be to cancel the current solicitation and incorporate that scope of work into the statewide solicitation.

At its January 27, 2005 meeting, the Operations Committee voted to recommend to the Board cancellation of the solicitation for actuary services, issued in July 2004.

Motion: Mr. Karl Polen moved to cancel the solicitation for actuary services issued in July 2004.

Mr. Jim Bruner seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding a Notice of Final Rulemaking for R2-8-115, Return of Contributions Upon Termination of Membership by Separation from Service by Other than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member, and R2-8-118, Application of Interest Rates

Ms. Nancy Johnson, ASRS Rules Coordinator, stated that this rulemaking amends R2-8-115 to update and clarify the procedure for the return of contributions when a member who has terminated or terminates employment by other than retirement or death, and the procedure for requesting survivor benefits upon the death of a member. The rulemaking also amends R2-8-118 to clarify the various interest rates allocated for various purposes in the past, and includes the change to 4% interest on funds withdrawn by plan members, but not system members.

At the August 20, 2004, ASRS Board meeting, the Board approved changing the interest rate on contributions withdrawn by plan members terminating membership in the ASRS from 8% to 4%, beginning with funds received on and after July 1, 2005. The Board approved the Notice of Proposed Rulemaking for R2-8-115 and R2-8-118 at their November 19, 2004, Board meeting. An Oral Proceeding was held regarding these rules on January 20, 2005, and the close of record was January 20, 2005 at 5 p.m. We received no comments regarding the proposed rules, therefore the rules in the Notice of Final Rulemaking are identical to the rules in the Notice of Proposed Rulemaking that was approved by the Board in November.

At its February 4, 2005, External Affairs Committee (EAC) meeting, the EAC voted to recommend to the Board approval of the Notice of Final Rulemaking for R2-8-115 and R2-8-118.

Motion: Mr. Jaime Gutierrez moved that the Board approve the Notice of Final Rulemaking for R2-8-115, Return of Contributions Upon Termination of Membership by Separation from Service by Other than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member, and R2-8-118, Application of Interest Rates with the appropriate amendment with the correction of the word interest on page one.

Ms. Anne Mariucci seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstention, and 0 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding State Legislation for the 2005 Legislative Session Relating to the ASRS Agenda

Mr. Gutierrez asked Ms. Susanne Dobel, Manager, External Affairs, to provide an overview to the ASRS Board. Ms. Dobel provided a status update on the following bills:

HB 2472 - ASRS; Payroll Deduction Agreements - **Status:** Approved by the Rules Committee, transmitted to Senate, Rules and Finance Committee. First read on 2/22/05.

HB 2473 - ASRS Retirees; Eligibility for AHCCCS - **Status:** Do Pass vote of 7-1-01-0 on 02/07/05.

HB 2474 - ASRS; Credited Service Purchase - **Status:** Held in Public Institutions and Retirement Committee on 02/21/05. NOW: Striker-Purchase of Military Service.

SB 1278 – Schools Best Practices - **Status:** 2/17/05 Senate Finance Committee amended; Do Pass as Amended Strike Everything Amendment. **NOW: Striker - Education Omnibus**

SB 1426 - Retirement; ASRS Spousal Consent - **Status:** Senate Finance Committee amended scheduled for 02/22/05 in Appropriations Committee.

Mr. Bob Letson, member from Tucson stated that three house bills; HB 2472, HB 2473, and HB 2474 are related to retirement. Mr. Letson, referred to a letter from the last legislative session from Assistant Attorney General, Fred Stork regarding benefit changes that impact members' vested rights. He also requested more information/clarification on SB 1428.

6. Presentation, Discussion and Appropriate Action Regarding Mercer's Analysis of Alternative LTD Funding Methods

Mr. Paul Matson, Director, stated in preparation for a full discussion at the March 18 Board meeting Trustees are encouraged to read the analysis. At the March meeting, funding model simulations and a series of staff recommendations will be presented.

7. Presentation, Discussion and Appropriate Action Regarding ASRS U.S. Equity Small Cap Manager(s) Review

Mr. Gary Dokes, Chief Investment Officer (CIO) and Mr. Terry Dennison, Principal, Mercer Investment Consulting, provided a review of the Small Cap U.S. Equity Managers.

Byram Capital Management underperformed its benchmark and the universe median for the recent quarter, but the results for all other periods evaluated are above the index and the universe median. Mercer rates this product B (average probability of outperformance). No organization concerns at this time.

Dimensional Fund Advisors (DFA) outperformed its benchmark for all periods evaluated. The fund placed above the universe median for all periods except for 5 years. Mercer rates this product B (average probability of outperformance). No organization concerns at this time.

Mellon is tracking the Russell 2000 Index closely for all periods evaluated. Mercer rates this product A (above average probability of outperformance). No organization concerns at this time.

8. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview for the Period Ending December 2004

Mr. Dennison presented an economic and market review and reported on the total fund for the period ending December 31, 2004.

	Quarter	1 Year	3 Years	5 Years	Inception
Total Fund	8.4%	11.5%	6.9%	2.4%	11.1%
Benchmark*	7.8	10.6	6.2	1.3	9.4
RM Public Funds Median	8.4	13.0	8.4	3.9	
Percentile Ranking	56	87	96	100	

* Interim Benchmark of 56% S&P 500/28% LB Aggregate/16% EAFE, which incorporates a proration of 6% real estate.

9. Presentation, Discussion and Appropriate Action Regarding the Investment Oversight Policy and Procedure

At the December 2004, Investment Committee (IC) meeting, the CIO made a presentation on potential conflicts of interest as it specifically pertains to the ASRS investment consultants. Such discussions focused on whether consultant compensation received from money managers for such services represents potential conflicts of interest and offers such managers preferential treatment during manager searches, etc., and influence recommendations made by consultants to their clients.

As a result, the IC in January 2005, approved the Investment Consultant Oversight Policy and Procedure. In short, the P&P memorializes the importance of disclosing relationships that exist between ASRS investment consultants and managers, the separation of investment duties that may be deemed to be perceived as a conflict of interest and the intent to not utilize the services of investment consultants who receive compensation from investment managers.

Motion: Mr. Larry Trachtenberg moved to approve the Investment Oversight Policy and Procedure.

Ms. Anne Mariucci seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

10. Director's Report

Mr. Matson stated that there are several legislative changes that may have negative financial implications on the System (e.g. 403B, DROP, and investment limitations).

The ASRS is requesting the approval from the Joint Legislative Budget Committee (JLBC) and Office of Strategic Budget Planning (OSBP) for the following:

1. Information Systems Division (ISD) - Update Information Technology (IT) Services.
2. Member Services Division (MSD) - Service Levels; Call Center and Production positions.
3. Investment Management Division (IMD) - additional FTE for the Real Estate Program.

Mr. Gutierrez asked Mr. Matson to provide an update on the Auditor General's Report. Mr. Matson stated that every ten years per state statute the Auditor General conducts a review of the ASRS. The Auditor General's Office is completing the sunset review of the ASRS. The following areas will be reviewed: Services, Investments, Contribution Rates, review of the Old System, and Procurement relating to Asset Management, Investment Management Consulting and Actuary Services.

Mr. Gutierrez commented to Mr. Matson about the increase of negative correspondence. Mr. Matson stated that the increase of negative correspondence was due to change in legislation, increase in service demands (service purchase), and Member Services Call Center staffing issues. The ASRS staff will make a formal presentation regarding service issues in March or April to address this.

Mr. Matson expressed gratitude to Ms. Charlotte Borchert and Mr. Jim Bruner for their service to the ASRS Board. Mr. Matson stated that Mr. Bruner has allocated his time for nine years for the benefit of retirees and future retirees of the ASRS. Mr. Bruner played a significant role in the adoption of the ASRS Board Governance Handbook. Both Mr. Bruner and Ms. Borchert will be missed.

Mr. Bruner stated that it has been an honor to serve more than 400,000 members of the ASRS. He stated that the biggest challenge while serving on the Board was the Legislature. A Committee of the Legislature wanted to provide direction to the ASRS on how to invest the beneficiaries' money. Trustees of the ASRS testified to the Legislature that the money does not belong to the Legislature, does not belong to the state as a whole, but to more than 400,000 members/beneficiaries. Mr. Bruner left with the following parting words, "The obligation of the ASRS is to benefit the beneficiaries/participants and not be involved in social legislation and or special interest investment objectives." He thanked past and present Trustees and ASRS staff for all their hard work and dedication.

11. Possible Presentation and Discussion Regarding Board Committee Updates

Mr. Gutierrez, Chairperson, EAC, stated the Committee will be busy for the next couple of months.

Mr. Townsend, Vice-chairperson, Operations Committee, stated that the Audit for FY 2004 Financial Statements was completed, and received an unqualified opinion, no findings or recommendations from the auditors. Mr. Townsend recognized the ASRS staff on their work, especially Nancy Linssen and Leslie De'Reche.

12. Board Requests for Agenda Items

None

13. Call to the Public

Mr. LeRoy Gilbertson, past Director of the ASRS addressed the Board. Mr. Gilbertson thanked Mr. Bruner for his professionalism, hard work, and advice throughout the years.

14. The next ASRS Board meeting is scheduled for Friday, March 18, 2005, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

15. Adjournment of the ASRS Board

Dr. Meredith adjourned the February 18, 2005, Board meeting at 10:05 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Erica Romero, Secretary

Date

Paul Matson, Director

Date